

Internal Revenue Service
memorandum

TL-N-1573-89

CC:TL;TS/LJBYUN

date: FEB 1 1989

to: District Counsel, Los Angeles W:LA
Attn: Joyce Sugawara

from: Assistant Chief Counsel (Tax Litigation) CC:TL

subject: Scar Issue: [REDACTED]

Docket No. [REDACTED]

This memorandum is in response to your request for technical advice regarding a Scar issue in the above-mentioned case.

ISSUE

Is the statutory notice of deficiency in this case valid under Scar v. Commissioner, 814 F.2d 1363 (9th Cir. 1987)?

CONCLUSION

This case should be conceded. Although the statutory notice reflected the right shelter, it reflected the wrong amount and applied the wrong rate by using the "plug rate." Furthermore, even though the transcript of account was available at the time the statutory notice was issued, not all of the relevant information from the transcript was used in determining the deficiency.

FACTS

A statutory notice of deficiency was issued to the [REDACTED] on [REDACTED], for the tax year [REDACTED]. The statutory notice specified a deficiency in the amount of \$ [REDACTED] arising from disallowed losses in the amount of \$ [REDACTED] and disallowed investment tax credit of \$ [REDACTED] with respect to [REDACTED]. The statutory notice used the "smoking gun language" of Scar ("In order to protect the government's interest and since your original income tax return is unavailable at this time, the income tax is being assessed at the maximum rate of [REDACTED] %."). The administrative file contained a transcript of account for the [REDACTED] tax year as of the [REDACTED] week of [REDACTED]. It appears that the only information taken from the transcript of account was the tax shown on the return. No information showing taxable income or AGI was used.

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The K-1 for [REDACTED] showed a loss of \$ [REDACTED] and amount subject to the investment tax credit of \$ [REDACTED] ([REDACTED] of which is \$ [REDACTED]). Although the [REDACTED] claimed the full \$ [REDACTED] of ITC, only \$ [REDACTED] of the loss was actually claimed on their [REDACTED] return.1/

DISCUSSION

Since this case lies within the Ninth Circuit, we recommend that the case be conceded based upon the Scar holding. Although the Service does not agree with the Ninth Circuit's "substantive content" standard for testing the validity of deficiency notices under section 6212(a), as a result of the uncertainty of the scope of Scar, the Service wants to restrict the impact of the decision to the facts in that case. Therefore, the Service will not relitigate the "determination issue" on facts not materially different from Scar.

It is our position that we do not need to have the original return to make a determination. Instead, we can rely on taxpayer return information found in the transcript of account, as well as relevant K-1s. Since it is our position that we can rely on the Service's data bases to make a determination, it is imperative that we actually use the information from the transcript to make the determination, as compared to "backing into" the deficiency. If we use the amount shown for AGI or taxable income from the transcript, as well as the amount shown for tax on return, plus the other information regarding the adjustments, a proper determination can be made.

Although this case is clearly distinguishable from the facts of Scar, this is not the type of case that we want to defend in the Ninth Circuit since it does not involve facts that justify application of our theory that a proper determination can be made by using relevant information from our data bases. If this case was in any other circuit, we would defend it.

Here, we made the right adjustment, but in the wrong amount. Furthermore, the 50 percent rate was incorrect. Taxpayers were not in the 50 percent bracket. In addition, we did not use all the relevant information that was available when the determination was made.

1/ If this was the only problem with the statutory notice, we would defend it since it is our position that we can rely on return information such as K-1s. We want to be able to show that some reasonable nexus existed between the disallowed deduction and the return. It is our position that information from the Service's data base records of taxpayer's return as well as third party information (such as a copy of K-1) raises a reasonable inference that the deduction was claimed.

Based upon the above facts, we do not recommend defending this case. Should you have any further questions regarding this matter, please contact Lisa Byun, Tax Shelter Branch, at FTS 566-3289.

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